EFInA Quarterly Review

(January to March 2009)

1 Nigerian Economy

In March 2009, the World Bank Managing Director, Dr. Ngozi Okonjo-Iweala said that Nigeria's non-oil GDP is expected to nearly halve this year and next, due to the weak availability of credit and tighter spending. She projected that the non-oil GDP growth in Nigeria would slow to around 4% in 2009 and 2010, from 7.7% in 2008. Okonjo-Iweala also stated that foreign direct investment (FDI) and remittances were expected to drop to a total of around $6 billion this year from $8.2 billion in 2008.

1.1 Debt

According to the Debt Management Office (DMO), as at February, the nation's external debt was $3.5 billion, down from the $38billion dollars owed to creditors before 2006. The domestic debt was N2.3 trillion. The DMO Director General, Abraham Nwankwo said that both the domestic and the external debt profile constitute about 11% of Nigeria's GDP. He also stated that 84% of the external debt was owed to multilateral institutions, such as the World Bank and the African Development Bank and all the loans were concessionary.

1.2 Unemployment

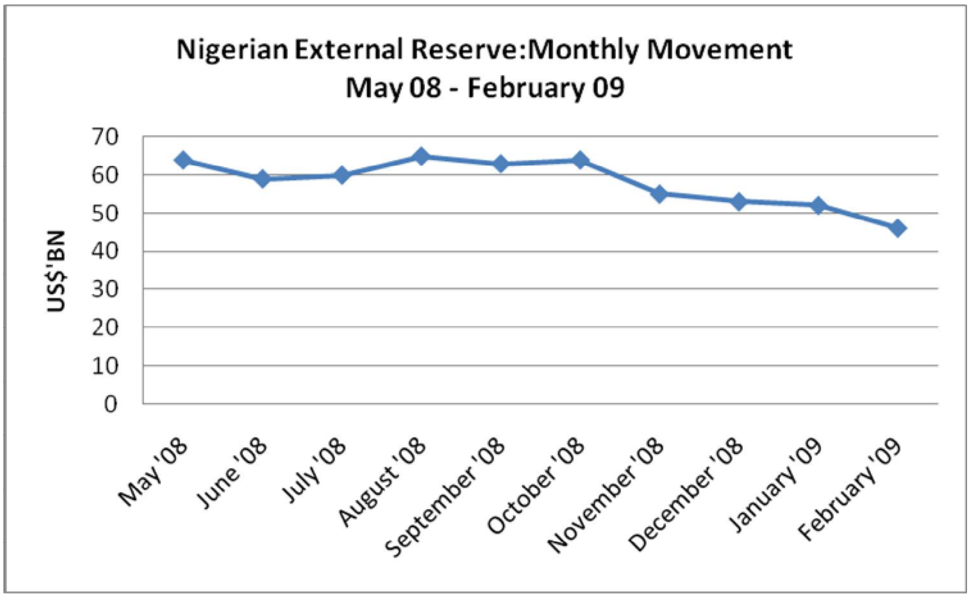
In February, an estimated 40 million Nigerians were unemployed as stated by the Labour and Productivity Minister, Kayode Adetokunbo. Most of the unemployed were between 18 and 25 years. Adetokunbo stated that majority of Nigerians were already living below the poverty line and that the Federal Government could not allow more Nigerians to be swept into the ever increasing poverty circle. His words: "The problem of unemployment and under-employment has for long constituted serious impediments to our strive for national growth and development". The World Bank also classified Nigeria among nations prone to widening poverty and socio-economic crisis arising from the effects of the economic melt down. According to Adetokunboh within the past eight years, Nigeria had witnessed an unprecedented increase in national earnings but unfortunately, this had not translated into job creation and economic empowerment for the people.

1.3 Inflation

According to the National Bureau of Statistics, Nigeria's consumer price inflation increased to 14.6% year-on-year in February from 14% in January, driven largely by higher food prices. The growth in food prices, which form the bulk of the index basket, rose to 20% year-on-year from 18.4% in January; and non food about 6%. The rise in the index was caused by an increase in the prices of staple foods like maize, yam, guinea corn millet, meat, fruit and vegetables. CBN expects that the average inflation rate during the year would not significantly deviate from 14 - 15% range.

1.4 External Reserves

The External Reserves has been in decline since May last year, as shown below.



1.5 Foreign Exchange

In its bid to arrest the falling naira value, CBN sold $5.81bn to end users between January and March, an increase of 10.57% over the $5.25bn sold in the fourth quarter of 2008 and an increase of 1,032% over the $513.09mn sold in the first quarter of 2008. Experts have warned that the current stability of the exchange rate of N145/$1 may not be sustainable. The implication of this is that the nation's foreign reserves remain at risk of disappearing if CBN continues to back the value of Naira.

In the first quarter of 2009, CBN offered a total of $5.9bn through the Retail Dutch Auction System which replaced the Wholesale Dutch Auction System on 19 January 2009. The offer represents an increase of 257.58% over the $1.65bn offered in the fourth quarter of 2008, and an increase of 793.94% over the $660mn offered in first quarter of 2008.

1.6 Nigerian Stock Market

The amount invested in stocks in the first quarter of 2009 was N106.91 billion which represents a dip of 89% from N990.42 billion invested in the first quarter of 2008. The N106 billion was invested in 19.03 billion shares, compared to 68.55 billion shares traded in 2008. Of the N106.9 billion, N40.15 billion was accounted for in March, N37 billion in February, and N29.8 billion in January. In March, the banking sub sector was the most active in volume terms.

2 Financial Sector

2.1 Banking Sector

The Nigerian banking industry, which in the last four years recorded tremendous performance, is currently being affected by the global financial meltdown that hit the international financial market towards the last quarter of 2008. However, economic experts have expressed optimism that the local banks could perform relatively well despite the effects of the financial meltdown. As at December 2008, the total balance sheet size of all the banks was N10.43 trillion versus N2.7 trillion recorded in 2003; which represents an increase of about 400%. Figures from the Central Bank of Nigeria shows that banks lending activities reached N7.4trillion by the end of 2008; up from about N4.6 trillion in 2007; which represents a 60% growth in lending by banks.

Margin Loans

In March, Professor Soludo, the Governor of CBN told a forum on the global crisis in Lagos that the total aggregate size of banks' exposure to margin loans was N800bn. Margin loans are treated like other commercial loans with loan loss provisions guided by the Prudential Guidelines. However, ARM Investment Managers believe this approach to margin loan loss provisioning increases the banks' credit risk and results in a wide divergence in the economic (true) and accounting value of such loans. ARM have estimated N540 billion to be the unrealised losses to be written off on margin loans based on an industry initial margin requirement of 33% and average stock price decline of 70%. Having realised the possible adverse impact of these exposures, CBN has responded by allowing banks to delay the classification of such loans till Dec 2009, contrary to the provision of the Prudential Guidelines.

Liquidity remains a serious issue

Despite the cancellation of CBN's directive for the harmonisation of banks' financial year end of December 2008, the liquidity dearth in the inter-bank market still persists. ARM Investment Managers attribute the sustained liquidity dearth to concerns over counter-party default risk. They expect the current tight liquidity situation to continue in the near term and to result in curtailing lending activities in 2009.

Return on Equity

Return on equity rose marginally to 13.1% in 2008, compared to 12.4% in 2007, but was still below the pre-consolidation levels. This strongly suggests that most banks still face challenges linking the issuance of additional equity to clearly exploitable near to medium-term opportunities, and are also unable to demonstrate that identified opportunities can earn acceptable incremental rates of return on capital.

Growing Concerns

In February 2009, Price Waterhouse Coopers (PwC) stated that some Nigerian banks might not be as healthy as portrayed by the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation (NDIC). According to PwC, in spite of positive financial statements, some of the banks have called for the intervention or part take over by the government. Various industry commentators have reported that banks are struggling with non performing facilities in excess of N300 billion to N400 billion. Western governments have taken stakes in banks in order to prevent their collapse. Whilst this has not yet happened in Nigeria, there is a speculation that large underlying bad debts accumulated by banks could force government to intervene. The Nigerian banks have all but stopped granting loans and credit terms have been cut to mere months and their interest rates are among the highest in the world. Over the last year, foreign investors divested more than N1 billion from the Nigerian capital market, driven by the reduced availability of financing and concerns on liquidity. The audit firm added that the NSE lost N5 trillion market capitalisation in 2008 and in January 2009 alone it dropped to a further N2 trillion.

Lending and Deposit Rates

To curb unhealthy competition and assuage the suffering of Nigerians in the face of worsening global economic crisis, CBN announced in March, that they had placed a ceiling on lending and deposit rates. This will allow the commercial banks to charge up to a maximum of 22% and 15% per annum respectively. This will take effect from 1 April. The Governor of CBN said the Banker's Committee observed that currently, in some cases, banks were charging as high as 32% as lending rates and give as high as 21% on deposits. According to the Governor "the cost of doing business by the banking sector is very high relative to most other economies, especially in the areas of power and security". As such, he added, in order to dampen the interbank interest rate, Central Bank will lend to banks at no more than 500 basis points above its Monetary Policy |Rate (MPR) at the discount window, which is a maximum of 14.75% at the current MPR.

2.1.1 Retail Banking: Nigeria's Banks Next Revolution?

Corporate or wholesale banking is said to have dominated banking operations in Nigeria because the financial institutions have a penchant for big ticket deals and tend to run away from the mass market who they perceive as high risk. It takes a different mindset to delve into retail banking.

In February 09, the Lafferty Group one of the world's leading specialists on research, publications and knowledge in retail banking visited Nigeria to meet with CEO's of banks to discuss ways of making a success of retail banking in Nigeria, to the level that can be compared to the best experiences in the world. Lafferty said "with Nigeria's teeming population of over 140 million it has a thriving market for retail banking". Lafferty said most countries have in the past 25 years have come to realise that retail banking is the real heart, future and foundation of modern banking. By retail banking, Lafferty means the provision of financial services to consumers no matter their levels.

Lafferty also said retailers with a huge consumer base such as Shoprite and the country's post offices can be part of the retail banking revolution, as they can tailor financial products such as accounts, credits, cards, payments, etc. efficiently and effectively to a community of customers. Although for this to happen, it would require a change in the regulatory environment in Nigeria. For example in Europe, non-bankers or big retailers are encouraged to be part of retail banking or payments. The people have changed their ways of thinking by creating a new licence for retailers to enable them move in with low capital. Lafferty also said it is only retail banking that can generate consistently high returns of between 15 to 20% per annum. Experts are also of the opinion that over the economic cycle, it is doubtful if corporate banking is a profitable business.

2.2 Microfinance

The Central Bank of Nigeria's Annual Supervision report revealed that Microfinance banks and other micro credit lending institutions have increased their assets by 136%, from $354 billion (N49.61 trillion) in 2005 to $838 billion (N117.34 trillion) in 2008. According to the report, out of 818 MFBs in the country, the entire northern region has 23.9% of MFBs, while 40.5% are in the South-West. Urban areas such as Lagos have the highest density of microfinance banks. The report also revealed that poverty was still very high in the North-East, which only has 4.1% geographical concentration of MFBs.

In February 2009, CBN announced that microfinance banks would soon be licensed to use ATMs to allow their numerous customers access to their funds. They stated that the introduction of ATMs to microfinance banks was one of the steps being taken by the Apex bank to strengthen the operations of the MFBs.

2.2.1 Impact of the Global Crisis

A large number of Microfinance Institutions (MFI's) in the country have been adversely affected by the global financial crisis. Prior to the global economic meltdown, some foreign financials institutions were queuing up to lend to local microfinance institutions - having viewed the rapid growth in the sector. However, Thisday Investigations revealed that since the onset of the crisis, foreign interest has greatly reduced.

Fitch, an international rating agency recently reported that contrary to some industry views, it will be difficult for the microfinance sector to remain immune from global financial crisis. It expects a funding or liquidity impact, which will increase the level of refinancing risk for MFIs, particularly for non deposit taking MFIs dependent on local or international wholesale funding. Fitch states that the current crisis is exposing some MFIs to the convergence risks of greater integration of microfinance within the banking sector. "Many MFIs will revisit their strategy of commercialisation and transformation," says Mark Young, Managing Director, Fitch's Financial Institutions Group.

3 Telecoms Sector

At the end of 2008, globally there were 4 billion mobile subscriptions world wide, which represents an average of 24% annual growth since 2000. According to the International Telecommunication Union (ITU), with or without a recession, millions of people in India, China, Nigeria and other emerging market will seek out mobile phones. In Nigeria specifically, mobile telephones are believed to be "a basic necessity" and enjoys persistent demand despite the economic downturn.

The popularity of mobile phones in developing markets like Nigeria could create an opportunity for technology “leapfrog”.

According to the NCC, as at February 2009, Nigeria had an active subscriber base of 66,603,264 with GSM operators having a combined figure of 58, 779,366 subscribers.